



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced	02/20/03	Bill No:	SB 541
Tax:	Motor Vehicle Fuel and Diesel Fuel	Author:	Torlakson
Board Position:		Related Bills:	

BILL SUMMARY

This bill would provide for an annually adjusted excise tax rate on gasoline and alternative fuels based on the percentage change in the California Consumer Price Index (CCPI).

ANALYSIS

Current Law

Under current law, an excise tax of \$0.18 per gallon is imposed on both gasoline and diesel fuel. For use fuels such as liquefied petroleum gas, compressed natural gas, ethanol, and methanol, the excise tax rates are \$0.06, \$0.07, \$0.09, and \$0.09, respectively.

In all three fuel law sections, there is a clause which states that the state excise tax will increase by an amount corresponding to the amount of any federal excise tax rate reduction below a specified amount, provided there is also a reduction in the amount of federal funding of state projects.

Proposed Law

This bill would amend Section 7360 of the Motor Vehicle Fuel Tax Law to provide for an adjustment in the excise tax imposed on gasoline based on percentage of change in the CCPI.

For the 2004 calendar year, the Board would re-compute the rate of tax based on the percentage change in the CCPI for all items from September 1, 1990 to September 1, 2003, as specified. The rate change calculated would be rounded to the nearest 1/10 of one cent.

For the 2005 calendar year and each year thereafter, the Board would re-compute the rate of tax based on the percentage of change in the CCPI for all items from September 1 of the prior fiscal year to September 1 of the current fiscal year, as specified. The rate change calculated would be rounded to the nearest 1/10 of one cent.

This bill also provides for the recalculation of the gasoline tax rate if the federal fuel tax is reduced below the rate of nine cents (\$0.09) per gallon and specified federal financial

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allocations to this state are reduced or eliminated correspondingly. The tax rate would be recalculated by an amount so that the combined state and federal tax rate per gallon equals nine cents (\$0.09) plus the tax rate computed by the Board.

This bill would amend Section 7361 to impose upon every distributor a floor stock tax on gasoline held in storage, for the purpose of removal, sale, or use.

This bill would also add Section 8651.1 to the Use Fuel Tax Law to provide the following Legislative findings and declarations:

- The excise tax on motor vehicle fuel was last increased on January 1, 1994, when the rate was set at eighteen cents (\$0.18) per gallon.
- The demand on California's state highways and streets and local roads has increased at a far greater rate than the revenues available to operate, maintain, and expand the transportation network.
- Increased motor vehicle fuel economy results in the consumption of less fuel and the generation of less gas tax revenue per mile driven, while inflation also erodes this slow-growing revenue.
- The Traffic Congestion Relief Act (Chapters 91, 92, and 656 of the Statutes of 2000) (TCRA) created a six-year funding plan using General Fund revenue for state and local transportation needs.
- The TCRA created the Traffic Congestion Relief Fund (TCRF) to support high-priority traffic-relief projects statewide, and the Transportation Investment Fund (TIF) to distribute funding for local street and road improvements, state highway improvements, and public transit.
- Rapid declines in state General Fund revenues have led to, and could create more, suspending of transfers of gasoline sales tax revenue to the TIF and revenue reductions in the TCRF.

In addition, Section 8651.1 would impose an excise tax for the use of fuel at an amount, adjusted annually for inflation, to replace any revenues suspended from transfer to the Transportation Investment Fund or reduced from the Traffic Congestion Relief Fund.

This bill would go into immediate effect as a tax levy.

Background

In 1990, voters approved Senate Constitutional Amendment 1 (Proposition 111) at the June direct primary election. Approval of this measure made operative Assembly Bill 471 (Ch. 106, Stats. 1989) and Senate Bill 300 (Ch. 105, Stats. 1989). These bills, among other things, increased the rate of tax imposed on most motor vehicle fuels from \$0.09 to \$0.14 per gallon, effective August 1, 1990. Further, on January 1, 1991, and each January 1 through 1994 thereafter, the excise tax increased by \$0.01 per gallon to the current \$0.18 per gallon.

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In 1997, Assembly Bill 653 (Papan) was introduced, which contained a proposal to index the per gallon tax on gasoline and diesel fuel according to the CCPI. That bill failed to pass out of the Assembly Committee on Transportation.

Assembly Bill 2114 (2000, Longville) would have also provided for an annually adjusted excise tax rate on gasoline and diesel fuel based on the percentage change in the CCPI. However, those provisions were removed from the May 17, 2000 version of the bill.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to increase the state excise tax on gasoline and diesel fuel to restore any funding transferred or cut from the Transportation Investment Fund and from the Traffic Congestion Relief Fund, and to index the gasoline tax annually for inflation.
2. **Suggested technical amendments.** Board staff is working with the author's office in drafting appropriate amendments to address the following concerns:
 - The inflation adjustment language should be removed from the Use Fuel Tax Law (Section 8651.1) and added to the Diesel Fuel Tax Law (commencing with Section 60001). According to the author's office, this bill is intended to increase the state excise on gasoline and diesel fuel, not alternate fuel.
 - The rate recomputation language for the 2005 calendar year, and each calendar year thereafter, should be clarified to provide that the inflation adjustment factor be multiplied by the prior year's motor vehicle fuel tax rate. The current language could be interpreted to mean that the inflation adjustment factor always be multiplied by 18 cents per gallon as provided in subdivision (a) of Section 7360.
 - The time period for the CCPI should be changed to align with time period in which the Department of Industrial Relations determines the CCPI, which is for even months only. Accordingly, the CCPI is determined for February, April, June, August, October and December. Board staff suggests using the percentage of change in the CCPI for all items from June of the previous fiscal year to June of the current fiscal year. This would be consistent with a month that the CCPI is determined, would provide the Board staff sufficient time to determine the rate and notify industry before the January 1 tax rate change, and would provide industry sufficient time for reprogramming.
3. **Initial adjustment.** This bill would, for the 2004 calendar year, adjust the gasoline tax for inflation based on the percentage of change in the CCPI for all items from September 1, 1990 to September 1, 2003. According to the author's background sheet, the adjustment is retroactive to 1990 since that is when the last gasoline tax increase became effective. However, the last gasoline tax increase (one cent per gallon) was effective January 1, 1994 pursuant to Proposition 111, which was approved by voters at the June 1990 direct primary election.

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4. **Purpose of the floor stock provisions.** A floor stock tax serves to equalize the excise tax paid by a wholesaler or retailer on fuel inventory and those gallons purchased after the effective date of a tax increase. Having a large gasoline or diesel fuel inventory before a tax rate increase takes effect can bring a small windfall to a seller. The selling price of gasoline or diesel can be raised and attributed to the tax rate increase, but the additional funds collected are profit and not an excise tax paid to the state. A floor stock tax mitigates this windfall.

It is suggested, however, that the floor stock tax be imposed only if the annually adjusted tax rate increases by \$0.02 per gallon or more. Because the excise tax is imposed at or near the first level of distribution of gasoline and diesel fuel, it requires extra effort to identify wholesalers, retailers, and users with large storage tanks who are not currently required to be registered taxpayers with the Board. A floor stock tax rate of \$0.02 per gallon, however, would make it cost effective to identify and register those taxpayers, in addition to processing their returns and payments. A higher threshold for the imposition of the floor stock tax would also make the provisions fairer to industry.

Board staff is working with the author's office in drafting appropriate amendments to address these concerns.

5. **This measure would not affect alternative fuels.** Alternative fuels, such as liquefied petroleum gas, compressed natural gas, ethanol, and methanol, are taxed under the Use Fuel Tax Law. This proposal is not intended to increase the tax rate for any of those fuels.
6. **State sales tax revenues.** Existing Sales and Use Tax Law expressly includes within the definition of "gross receipts" and "sales price" the amount of any tax imposed by the United States upon producers and importers and the amount of tax imposed by the state under the Motor Vehicle Fuel Tax Law. Accordingly, the sales tax applies to both the federal and the state excise tax in addition to the sales price per gallon. The following is an example of the price of gasoline computed on a tax-included basis:

Sales price per gallon of gasoline net of all taxes	\$1.153
Federal excise Tax	.184
State excise Tax	.180
Total	\$1.517
Sales tax reimbursement computed at 7¼% of \$1.517	.110
Total tax-included price per gallon	\$1.627

Therefore, if, as a result of this bill, the excise tax on gasoline were increased (reflecting a corresponding increase in the CCPI), then the state sales tax on gasoline would generate corresponding additional revenues.

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The provisions in current law which include the federal and state excise tax in the selling price of gasoline within the computation of sales tax were added by Senate Bill 325 (Ch. 1400, 1971), which also, for the first time since enactment of the Sales and Use Tax Law in 1933, imposed the sales and use tax on sales of gasoline.

In the case of diesel fuel, the \$0.18 per gallon diesel excise tax is not included in the calculation for gross receipts. When the imposition of the diesel fuel tax was moved to the terminal rack by SB 840 (Ch. 555, Stats. 1995), a specific exclusion from the sales and use tax was added to the law. Because the tax on diesel fuel had previously been imposed on the user of the fuel, the diesel fuel tax has never been included in the amount subject to the sales tax. Therefore, for purposes of calculating sales tax, the state does not include the \$0.18 per gallon excise tax on diesel fuel. The following is an example of diesel fuel prices computed on a tax-included basis:

Sales price per gallon of gasoline net of all taxes	\$1.103
Federal excise Tax	.244
Total	\$1.347
Sales tax reimbursement computed at 7¼% of \$1.347	.098
State excise Tax	.180
Total tax-included price per gallon	\$1.625

7. **Would an increase in the gasoline and diesel fuel taxes increase evasion?** It is estimated that the gasoline and diesel tax rates for the 2004 calendar year would increase from 18 cents to 24.5 cents per gallon of fuel. It is assumed that such an increase in the fuel tax rates, along with annual adjustments to the tax rate based on the CCPI, would cause a correlated increase in tax evasion.
8. **Would an increase in the gasoline and diesel fuel taxes decrease the sale of fuel in California?** Truckers who currently purchase fuel in California may begin to purchase fuel in bordering states if the combined fuel tax and sales tax on fuel in California results in fuel prices higher than those in bordering states. Or if forced to fuel up in this state, truckers may purchase only enough fuel to get them to an out of state location. Fuel tax rates in California and its bordering states are as follows:

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	Gasoline Tax (per gallon)	Diesel Fuel Tax (per gallon)
California	18 cents	18 cents
Arizona	18 cents	26 cents
Nevada	23 cents plus local fuel taxes	27 cents plus local fuel taxes
Oregon	24 cents plus local fuel tax	24 cents plus local fuel tax (cars and pickups)

It should be noted that California's bordering states do not impose a state sales tax on fuel. For example, diesel fuel selling in California at \$1.625 has state tax of \$0.278 (fuel tax of \$0.18 and sales tax of \$0.098) and diesel fuel selling in Reno, Nevada has a fuel tax of \$0.27. If the fuel tax increases to \$0.261, the combined California tax would be \$0.359.

COST ESTIMATE

A detailed cost estimate is pending. However, the Board would incur costs related to this measure for notifying taxpayers, developing returns, computer programming, developing and carrying out compliance and audit efforts to ensure proper reporting, administering a floor stock tax, and investigative efforts. From experience, the Board would anticipate higher excise tax rates to invite riskier tax evasion schemes. In order to properly protect the state's revenue from increased incidences of tax evasion, the Board would incur higher audit and compliance staff costs with each additional increase in the excise tax rate.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

For Calendar Year 2004

This bill would require the Board to re-compute the excise tax of \$0.18 per gallon on gasoline and diesel fuel. The computation suggested for the adjustment is as follows:

- An inflation adjustment factor would be calculated by adding 100% to the percentage change in the Consumer Price Index (CPI) for all items from September 1, 1990, to September 1, 2003, inclusive, no later than November 1, 2003. The result would be divided by 100.

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- The current rate of \$0.18 would then be multiplied by the inflation adjustment factor as determined above. The result would be rounded off to the nearest one tenth of one cent (\$0.001) per gallon.

As of 1998, the CPI is being reported on an every other month basis, meaning that there is no CPI for the month of September. And at the time of preparing this revenue estimate, there is no reporting of CPI for the year 2003. As an indication of the potential outcome of an adjustment, we used the average CPI from 1990 to 2002 to determine a tax rate for the year 2004. The following depicts a brief explanation:

Percentage Change – CPI

Average CPI – 1990	135.0
Average CPI – 2002	186.1
Percentage Change	37.9% $((186.1 - 135.0) / 135.0)$

Inflation Adjustment Factor

$$100\% + 37.9\% = 137.9\%$$

$$\text{Factor} = 1.379 \text{ (137.9 divided by 100)}$$

Adjusted Tax Rate

$$0.18 \times 1.379 = \$0.24822$$

Increase In Tax Rate

$$\$0.248 - \$0.180 = \$0.068$$

Based on 2001 Net Taxable Gasoline Gallons, it is estimated that in the year 2004 with the new tax rate, there would be an estimated \$1 billion increase in gasoline tax revenues $(\$0.068 \times 15 \text{ billion gallons} = \$1 \text{ billion})$.

Based on 2001 Net Taxable Diesel Gallons, it is estimated that in the year 2004 with the new tax rate, there would be an estimated \$177 million increase in diesel fuel tax revenues $(\$0.068 \times 2.6 \text{ billion gallons} = \$177 \text{ million})$.

At the time of preparing this estimate, calendar year 2002 fuel gallonage figures were not available.

In addition to the revenue generated by the tax increase, a proposed floor tax will serve to mitigate any windfall to wholesalers and retailers benefiting from having large gasoline or diesel fuel inventory on hand before a tax rate increase takes effect. The selling price of gasoline or diesel can be raised and attributed to the tax rate increase, but the additional funds collected are profit and not an excise tax paid to the state. Prior floor stock taxes on fuel have shown that approximately 3 days worth of fuel would be on hand and subject to the floor stock tax. This would amount to 123.3 million $(15 \text{ billion} / 365 \times 3 \text{ days})$ gallons of gasoline and 21.4 million $(2.6 \text{ billion} / 365 \times 3 \text{ days})$ gallons of diesel fuel. The revenue generated from imposing a floor tax amounts to \$8.4 million $(123.3 \text{ million} \times \$0.068)$ for gasoline, and \$1.5 million $(21.4 \text{ million} \times \$0.068)$ for diesel.

Revenue Summary

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The revenue gain from adjusting the tax rate by \$0.068 per gallon of gasoline and diesel fuel for the calendar year 2004 is as follows:

	Revenue (In millions)
Excise Tax on Gasoline	\$1,000.0
Floor Stock Tax on Gasoline	<u>8.4</u>
Total Gasoline	\$1,008.4
Excise Tax on Diesel	\$ 177.0
Floor Stock Tax on Diesel	<u>1.5</u>
Total Diesel	\$ 178.5
Total Excise Tax	\$1,186.9
State Sales & Use Tax on Gasoline* (5%)	\$ 50.4
Total State	\$1,237.3
Local Sales & Use Tax on Gasoline (2.25%)	\$ 22.7
Transit Tax on Gas (0.67%)	\$ 6.8
Grand Total	\$1,266.8

*As explained in Comment 6, the gasoline tax, but not the diesel fuel tax, is subject to the sales tax.

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